

# **Report to the Audit and Governance Committee**



**Epping Forest  
District Council**

**Report reference: AGC-005-2009/10**

**Date of meeting: 21 June 2010**

**Portfolio: Finance and Economic Development**

**Subject: Review of the Effectiveness of the System of Internal Audit**

**Responsible Officer: Brian Bassington (01992 564446).**

**Democratic Services Officer: Gary Woodhall (01992 564470).**

## **Recommendations**

**(1) To note the review of the effectiveness of the system of internal audit, undertaken by the Corporate Executive Forum for 2009/10, in the context of the Council's Governance Statement; and**

**(2) To scrutinise the review and consider the effectiveness of the system of internal audit in 2009/10.**

## **Executive Summary:**

The Accounts and Audit Regulations include a requirement for the Authority to carry out an annual review of the effectiveness of its system of internal audit as part of the wider review of the effectiveness of the system of governance.

This report summarises the review undertaken for 2009/10 by the Corporate Executive Forum, to assist the Committee in assessing the effectiveness of the system of internal audit on behalf of the Authority.

## **Reasons for Proposed Decision:**

To provide the Committee with the opportunity to scrutinise the review.

## **Other Options for Action:**

No other options.

## **Report:**

### Introduction

1. Regulation 6 of the Accounts and Audit Regulations requires the Council to maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper internal audit practices. In EFDC the system of internal audit consists of the work of the Internal Audit Team, although supervisory processes in all Directorates provide a control and risk management function that could be defined as contributing to the system of audit. For this purpose, however, the work of the Internal Audit Team is seen as the focus of the review of effectiveness.

2. The Council is required to carry out an annual review of the effectiveness of its

system of internal audit, as part of a wider review of the effectiveness of the system of governance. It is the responsibility of the Authority to undertake the review, and not the External Auditor. The Audit and Governance Committee is the most appropriate body to oversee the review of the system of Internal Audit, as it is independent of the management of the Authority.

3. The framework for the review should demonstrate that the Internal Audit service is:

- (a) meeting its aims and objectives;
- (b) compliant with the CIPFA Code of Practice;
- (c) effective, efficient and continuously improving; and
- (d) adding value and assisting the Authority in meeting its objectives.

4. The framework must also include, but not be limited to:

- (a) a comprehensive set of targets to measure performance;
- (b) user feedback for each individual audit and periodically for the whole service;
- (c) internal quality reviews to be conducted periodically to ensure compliance with the CIPFA Code of Practice; and
- (d) an action plan to implement improvements.

5. The objective of these measures is to ensure that the performance and effectiveness of the Internal Audit service improves over time, in terms of both the achievement of targets and the quality of service provided to the user.

6. Along with compliance with the Code of Practice, the review is to agree the effectiveness of the service. The outcome of the review is independent confirmation that the opinion in the annual report of the Chief Internal Auditor may be relied upon as a key source of evidence in the Governance Statement.

7. Measures of effectiveness put in place by the Chief Internal Auditor are based on existing reports and performance indicators, generally designed to measure outputs and outcomes. The key effectiveness measures are:

- (i) completion of the annual audit plan (Local Performance Indicator);
- (ii) productive audit time as a percentage of total time (LPI);
- (iii) cost per audit day (LPI);
- (iv) achieving client service satisfaction (LPI);
- (v) completion of audits within budgeted days; and
- (vi) finding improvements in control during each audit.

8. The measures referred to in the previous paragraph are monitored by Senior Management and Members via the following reporting processes:

- (a) Preparation of the Annual Internal Audit Plan;

- (b) Periodic monitoring reports by the Chief Internal Auditor, including:
- (i) Quarterly Monitoring reports including Audit Plan progress;
  - (ii) Reports on significant findings;
  - (iii) Local performance indicators as referred to above;
  - (iv) Results of customer satisfaction surveys; and
  - (v) Annual report and opinion of the Chief Internal Auditor.

9. The Council's Internal Audit Team issue a survey sheet after each main audit, and these are used in calculating one of the Team's local performance indicators, as well as providing feedback on Directorates' perception of the quality of the work and professionalism of the audit staff. An overall score of between 1 (poor) and 5 (excellent) is requested from the clients and of the questionnaires returned, 75% were scored at 5 and 25% at 4, from a return rate of 27%. Additional comments on the work of Internal Audit were invited, and where provided were constructive and showed a good level of understanding of the audit process.

10. The Council's External Auditors, PKF (UK) LLP, conduct a thorough review of the quality of Internal Audit's work on financial systems each year, in assessing the extent of reliance that can be placed on the work, in the context of their audit of the Council's Statutory Accounts. The Annual Governance Report 2008/09, issued by PKF in September 2009 stated:

- (a) *"Where possible, we have placed reliance on Internal Audit's work and thereby avoided unnecessary duplication of audit effort. To ensure this approach was valid, we have undertaken the following:*
- reviewed Internal Audit's working papers and reports*
  - considered the robustness of the key financial systems on the evidence of this work*
  - re-performed Internal Audit's evaluation of controls and a sample of their testing of the effectiveness of controls, to ensure that their conclusions are soundly based."*
- (b) *"In order to identify the fraud risks, and the controls you have put in place to mitigate those risks, we have:*
- discussed your anti fraud and corruption arrangements with officers, and those charged with governance*
  - considered the extent to which the work of Internal Audit is designed to detect material misstatements in the accounts arising through fraud*
  - made enquiries regarding instances of actual fraud you have identified."*
- (c) *"We were able to place reliance on Internal Audit's work for the testing of the effectiveness of specific controls."*

11. The review by External Audit does not cover all elements of the system of internal audit and, therefore, in the Audit Commission's view, cannot be relied upon to fulfil the requirements of the Regulations in relation to the annual review of effectiveness. The Council's External Auditors have reviewed the work of Internal Audit in 2009/10, which includes in this year, the reports and working papers of the externalised element of the audit plan carried out by Deloitte & Touche Public Sector Internal Audit Ltd. The External Auditor will be reporting their findings later in the year.

12. The review of effectiveness does not specifically include the value for money of the Internal Audit Team. Whilst this is an important issue in itself (and is a local performance indicator for the Team), the focus of this review is on the delivery of the internal audit service to the required standard in order to produce the required outcome i.e. a reliable assurance on

internal control and other governance arrangements, and the management of risks in the authority.

#### Review of Effectiveness of the System of Internal Audit 2009/10

13. The Council's Corporate Executive Forum has undertaken the review of EFDC's Internal Audit Service in 2009/10 utilising the following main sources of evidence:

- The annual report and opinion of the Chief Internal Auditor;
- A review of the Internal Audit Service against CIPFA standards using a check list provided in the guidance and now included in the CIPFA Benchmarking return;
- A review of Internal Audit monitoring reports for 2009/10;
- Any comments from the Chief Executive and Deputy Chief Executive following their consideration of individual audit report summaries;
- The role of the Corporate Executive Forum monitoring the work of Internal Audit and any significant internal control issues raised in their reports;
- Consideration of significant corporate control issues highlighted in audit reports, discussed within the Management Board;
- Performance by Internal Audit against local performance indicators; and
- The Internal Audit section of the Office of the Chief Executive Business Plan and work plans.

#### Corporate Assessment by the Audit Commission - Summary of Findings

14. The Internal Audit Section can demonstrate that it has a good understanding of the functions of the Council and has achieved the Council's objective to identify improvements to its control systems. The performance of the Unit has remained close to its key targets and while the actual audits achieved (87%) fell just short of the target (90%) for completion of the audit plan due to vacancies throughout the year, all fundamental financial systems were examined and reported on. The Council's External Auditors were able to place reliance on the work of Internal Audit when conducting their formal review of the Team's work as part of their review of the 2008/09 accounts.

15. The CIPFA Code of Practice checklist has now been included in the CIPFA Benchmarking return as a required data set. This Good Practice Questionnaire returns an automated compliance score, of which the Internal Audit Section have scored 180 out of a maximum of 192. The areas of non or partial compliance will be reviewed over the coming year and action taken to address any weaknesses.

16. The work of the Audit and Governance Committee, with independent membership, makes an important contribution to the independent review of internal and external audit processes, as part of the Council's arrangements for securing further improvements in its systems of governance, including internal control. The Annual Report of the Audit and Governance Committee for 2009/10 demonstrated the range of issues addressed during the year.

17. It is felt that the current Audit Committee complies with the key features of an Audit Committee as expressed by CIPFA, specifically that the Committee has:

- (a) A strong Chairman displaying depth of skills and interests;
- (b) An unbiased approach to its work;
- (c) The ability to challenge the Executive when required; and
- (d) A membership that is objective, independent and knowledgeable.

18. In the opinion of the officers attending the Audit and Governance Committee, the

continued support given by Members, in particular by insisting on responses to audit recommendations being timely, is invaluable in reinforcing the message of sound governance.

19. Having considered these issues, the Corporate Executive Forum is satisfied that the Authority's system of Internal Audit was effective during 2009/10.

**Resource Implications:**

From existing resources.

**Legal and Governance Implications:**

Within the report.

**Safer, Cleaner and Greener Implications:**

No specific implications.

**Consultation Undertaken:**

Corporate Executive Forum.

**Background Papers:**

CIPFA Audit Code of Practice.

**Impact Assessments:**

Risk Management

The annual review of the effectiveness of the system of Internal Audit needs to provide assurance that effective risk management measures are in place. This is demonstrated both by the specific audit of risk management processes undertaken by Internal Audit each year, and the emphasis on risk assessment when compiling the annual audit plan.

Equality and Diversity:

*Did the initial assessment of the proposals contained in this report for relevance to the Council's general equality duties, reveal any potentially adverse equality implications?* No

*Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken?* No

*What equality implications were identified through the Equality Impact Assessment process?*  
There are no specific equalities impacts.

*How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?*  
There are no specific equalities impacts.